523/985

Department of the Treasury
Internal Revenue Service

Publication 523
(Rev. Nov. 85)

Tax Information on Selling Your Home

For use in preparing
1985 Returns

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Introduction

This publication explains the basis of a home, how you may postpone the tax on part or all of the gain on the sale of your home, and how you may exclude part or all of the gain from your gross income if you are 55 or older.

Basis

Basis is a way of measuring your investment in property for tax purposes. Whether you bought your home, hired a contractor to build it for you, built it yourself, or received it in another way, it is important that you know its basis. The basis of property you buy is usually the cost or purchase price. You must know its adjusted basis to figure gain or loss when you sell or otherwise dispose of your home. You also must know the adjusted basis at the time of a casualty to determine your deductible loss from the casualty. If you change your home to rental or business use, your depreciation is based on the fair market value of the home or its adjusted basis at the time of the change, whichever is less.

Cost as basis. The cost of property is the amount that you pay for it in cash or other property.

Purchase. The original basis of a home you bought is the purchase price or cost of the property to you. This includes your down payment and any debt, such as a first or second mortgage, or notes you gave to the seller. Certain settlement or closing costs are added to or deducted from your basis. See *Settlement fees or closing costs* under *Cost of New Home*, later.

Construction. If you contracted to have your house built on land that you own, your original basis is your basis of the land plus the amount it cost you to complete the house. This includes the cost of labor and materials, or the amounts paid the contractor, and any architect's fees, building permit charges, utility meter and connection charges, and legal fees that are directly connected with building your home. If you built all or part of your house yourself, its original basis is the total amount it cost you to complete it. Do not include the value of your own labor or any other labor you did not pay for in the cost of the house.

Other basis. Sometimes you must use a basis other than cost, such as fair market value. For a complete discussion of basis, see Publication 551, *Basis of Assets*.

If you buy property on a time-payment plan (such as a mortgage loan) that charges little or no interest, the basis of your property is your purchase price less the amount considered to be interest. To determine the amount of interest, see the discussion on unstated interest in Publication 537, *Installment Sales*.

Gift. If someone gave you your home, its original basis to you is whatever the donor's adjusted basis was when the gift was made. However, if the donor's adjusted basis was more than the fair market value of the home when it was given to you, you must use that fair market value as your basis for measuring any possible loss if you later sell or exchange the home. You still use the donor's adjusted basis to measure any gain.

If the fair market value was more than the donor's basis at the time of gift, your basis is the donor's adjusted basis at the time you received the gift. Increase your basis by any federal gift tax paid on the gift, for gifts made ***before 1977.*** However, this increase never can raise the basis to more than the fair market value of the home when it was given to you.

If you received a gift ***after 1976,*** your basis is the donor's adjusted basis increased by the part of the gift tax paid that is due to the net increase in value of the gift. This part is figured by multiplying the gift tax paid on the gift by a fraction. The numerator (top part) of the fraction is the net increase in value of the gift and the denominator (bottom part) is the amount of the gift. The net increase in value of the gift is the fair market value of the gift less the donor's adjusted basis.

Inheritance. If you inherited your home, the original basis of the home is its fair market value at the date of the decedent's death or the later alternate valuation date if that date was used for federal estate tax purposes. If an estate tax return was filed, the value listed there for the property generally is your basis. If no return was filed, you should use the best available objective evidence of fair market value, such as a competent appraisal.

Trade. If you acquired your home in a trade for other property, the original basis of your home is the adjusted basis of the property you gave up, plus any recognized gain or cash difference you paid, and minus any recognized loss or cash difference you received. If you traded your old home for your present one and realized a gain, see *If you trade your old home* under *Exclusion of Gain*, later in this publication.

Adjusted basis. This is your original basis ***increased*** or ***reduced*** by certain amounts. You must increase your basis by the cost of improvements, additions, and other capital items. You may also add assessments for local benefits, such as streets and sidewalks, to your basis. You must reduce the basis by any deductible losses from fire or other casualty, payments you receive for any easements or rights-of-way you give up, and any depreciation or residential energy credit you claimed. You may not add to your basis certain settlement fees or closing costs such as "points," fire insurance premiums, mortgage insurance premiums, or charges for services concerning occupancy of the house.

Improvements add to the value of your home, prolong its useful life, or adapt it to new uses. Improvements, which you add to the basis of your property, should not be confused with repairs, which you do not add to the basis. ***Repairs*** maintain your home in good condition. They do not add to its value or prolong its life.

Examples. Putting a recreation room in your unfinished basement, adding another bathroom or bedroom, putting up a fence, putting in new plumbing or wiring, putting on a new roof, or paving your driveway are improvements that you add to basis. On the other hand, repainting your house inside or outside, fixing your gutters or floors, mending leaks or plastering, and replacing broken window panes are examples of repairs. However, if items that would otherwise be considered repairs are done as part of an extensive remodeling or restoration of your home, the entire job is considered an improvement.

Postponed gain. If you postponed gain on the sale of an old home according to the rules in this publication, the basis of your new home is the basis as discussed earlier less the postponed gain. See the illustrated *Example*, later.

Purchase credit. The tax credit on the purchase of a new home acquired and occupied after March 12, 1975, and before January 1, 1977, has no effect on its basis.

Energy credit. You must reduce the basis of your home by the amount of the residential energy credit allowed for energy saving and renewable energy source items you installed. You should add the cost of the items to the basis of

your home. For information on the residential energy credit, see Publication 903, *Energy Credits for Individuals.*

Recordkeeping. You should save receipts and other records for all improvements, additions, and other items that affect the basis of your home. Keep them for at least 3 years after the year you sell your home.

Treatment of Gain

Tax on part or all of the gain from the sale of your principal home (residence) may be postponed. If you buy a new home, and the purchase price of the new home is at least as much as the adjusted sales price of the old home, you may be able to postpone the tax on all the gain from the sale. If you do not buy a new home, or if the purchase price of the new home is less than the adjusted sales price of the old home, you will be subject to tax on some or all of the gain, unless you qualify to exclude the gain as explained later.

Any gain that you do not postpone is taxable as long-term or short-term capital gain, depending on how long you owned your home.

Purchase price at least as much as sales price. Your entire gain on the sale or exchange of your home is not taxed at the time of the sale if, within 2 years before or 2 years after the sale, you buy and live in another home that costs at least as much as the adjusted sales price (described later) of the old home. If you are on active duty in the armed forces, or if your tax home is outside the United States, the 2-year period may be suspended. See *Members of the armed forces* and *People abroad* under *Time for Replacement*, later.

Purchase price less than sales price. If the purchase price of your new home is less than the adjusted sales price of your old home, and you buy and live in the new home within the time period given above, the gain taxed in the year of the sale is the lesser of:

1) The gain on the sale of the old home, or
2) The amount by which the adjusted sales price of the old home is more than the purchase price of the new home.

Postponing the gain. You ***must*** postpone the gain if you replace your old home within the required period. If you have more than one home, you postpone the gain only on the sale of your ***principal*** home.

The tax on the gain is postponed, not forgiven. You subtract any gain that is not taxed in the year you sell your old home from the cost of your new home. This gives you a lower basis in the new home. If you sell the new home in a later year and again replace it, you may continue to postpone any tax on your gain.

Example. You sold your home in 1985 and had a $5,000 gain. Within 2 years, you bought another home for $60,000, which is more than you received for the old one. The $5,000 gain will not be taxed in 1985 (the year of sale), but you must subtract it from the $60,000. This makes the basis of your new home $55,000. If you later sell the new home for $66,000, and do not buy and live in a replacement home within the required time, you will be subject to tax on the $11,000 gain ($66,000 minus $55,000) in the sale year.

You need not use the same funds received from the sale of your old home to buy or build your new home. For example, you may use less cash and increase the amount of your mortgage loan.

Loss on sale. You may ***not*** deduct a loss on the sale or exchange of your home. The loss has no effect on the basis of your new home.

Reimbursement from your employer covering the loss on the sale or exchange of your home or for the expenses of the sale or exchange if your employer transfers you to a new location must be included in your income. For more information, see Publication 521, *Moving Expenses.*

Caution. If you have a gain from the sale of your home and you do not plan to replace it, or you do not meet the requirements for postponing gain, you may have to make estimated tax payments. For more information, see Publication 505, *Tax Withholding and Estimated Tax.*

Principal Home

Usually, the home in which you live is your principal home (residence). The home that you sell and the one you buy to replace it must both qualify as your principal home. *Property partly used as your home* and *Home changed to rental property* are discussed later in this publication.

A houseboat or mobile home may be your principal home.

Cooperative apartments. If you own a co-op apartment, that apartment may be your principal home. Your basis in the apartment is usually the cost of your stock in the co-op housing corporation, which may include your share of a mortgage on the apartment building.

Condominiums. A condominium home or apartment may be your principal home. Your basis is your cost, which also may include your share of the mortgage on the common parts of the development or structure.

Furniture, appliances, and similar items that are not fixtures (permanent parts of the property) generally are not part of your principal home.

Land. If you sell the land on which your principal home is located, but not the house itself, you may not postpone any gain you have from the sale of the land. For example, you sell the land on which your principal home is located. Within the replacement period, you buy another piece of land and move your house to it. This sale is not considered to be a sale of your principal home and you may not postpone any gain on the sale. This rule applies to sales after March 27, 1983.

More than one home. If you have more than one home, only the sale of your principal home qualifies for postponing the tax. For example, you own and live in a house in town and also own beach property, which you use in the summer months. The town property is your principal home; the beach property is not.

If you have two homes and live in both of them, your principal home is the one you live in most of the time.

If you own a house, but live in another house for which you pay rent, the rented home is your principal home. But if a house you own is your principal home, you may temporarily rent it out before its sale without changing its character as your principal home.

Old Home

To figure the gain on the sale of your old home, you must know the selling price and the amount realized.

Your gain is the amount realized minus the adjusted basis of the home. See *Basis*, discussed earlier, to figure the adjusted basis of your property.

Selling price. The selling price is the total amount you receive for the property, including money, all notes, mortgages, or other debts that are part of the sale, and the fair market value of other property you receive. If you receive a note or mortgage with no stated interest or a low rate of interest on the sale of your old home, see the discussion of unstated interest in Publication 537.

If you have to sell your home because of a job transfer, and your employer pays you for a loss in value of your home, do ***not*** include the payment as part of the selling price. Include it in your gross income as compensation for services on line 7 of Form 1040.

Amount realized. The amount realized is the selling price minus selling expenses.

Selling expenses include commissions, advertising, and legal fees. Loan charges paid by the seller, such as loan placement fees or "points," are usually a selling expense.

Moving expenses. If your move was job related, some expenses of selling a home may be deducted as moving expenses. See Publication 521.

Adjusted sales price. The adjusted sales price of the old home is important in finding the part of the gain on which tax is postponed. The adjusted sales price is the amount realized minus any fixing-up expenses you might have. Compare the adjusted sales price with the cost of the new home to find the gain on which tax is postponed.

Fixing-up expenses must:

1) Be for work done during the 90 days before you sign the contract to sell, and
2) Be paid within 30 days after the sale, and
3) Not be deductible in arriving at your taxable income, and
4) Not be used in figuring the amount realized, and
5) Not be capital expenditures or improvements.

Caution. You consider fixing-up expenses ***only*** in finding the gain on which tax is postponed. You may ***not*** deduct them in figuring the actual profit on the sale of the old home.

Example. Your old home had a basis of $45,000. On January 6 you sold it for $61,400. Selling expenses were $5,000. During the 90-day period ending January 6, you had the following work done. You paid for the work on February 1—within 30 days after the sale.

Inside and outside painting	$800
New venetian blinds and new water heater	$900

Within the required time you bought and lived in a new home that cost $54,600. The amount of gain postponed, not postponed, and the basis of your new home are as follows:

1) Selling price of old home	$61,400	
2) Minus: Selling expenses	5,000	
3) Amount realized		$56,400
4) Basis of old home	$45,000	
5) Add: Improvements (blinds and heater)	900	
6) Adjusted basis of old home		45,900
7) Gain on old home [(3) minus (6)]		$10,500
8) Amount realized on old home	$56,400	
9) Minus: Fixing-up expenses (painting)	800	
10) Adjusted sales price		$55,600
11) Cost of new home		54,600
12) Gain not postponed [(10) minus (11)]		$ 1,000
13) Gain postponed [(7) minus (12)]		$ 9,500
14) Cost of new home		$54,600
15) Minus: Gain postponed [item (13)]		9,500
16) Basis of new home		$45,100

Trading homes. If you trade your old home for another home, the trade is treated as a sale and a purchase.

Example. You owned and lived in a home that had a basis of $41,000. A real estate dealer accepted your old home as a trade-in and allowed you $50,000 toward a new house priced at $80,000. You are considered to have sold your old home for $50,000 and to have had a gain of $9,000 ($50,000 minus $41,000). Because you replaced it with a new home costing more than the sales price of the old one, you must postpone the tax on the gain. The basis of your new home is $71,000 ($80,000 cost minus $9,000 gain that is not currently taxed).

If the dealer had allowed you $27,000 and assumed your unpaid mortgage of $23,000 on your old home, $50,000 would still be considered the sales price (the trade-in allowed plus the mortgage assumed).

Property partly used as your home. You may use your property partly as your home and partly for business or to produce income. Examples are a working farm on which your house is located, an apartment building in which you live in one unit and rent out the others, or a store building with an upstairs apartment in which you live. If you sell the whole property, you postpone only the tax on the part used as your home. This includes the land and outbuildings, such as a garage for the home, but not those for the business or the production of income.

You must reinvest in the new home only the part of the selling price for the part used as your home, to have the tax on that part of the gain postponed. If you use only part of the new property as your home, only the cost for that part counts as reinvestment. You should look at the whole transaction as the sale of two properties.

Example. You own a four-unit apartment house. You live in one unit and rent three units. You sell the apartment house, and buy and live in a new home. Your records show:

Apartment house:	
Cost	$ 80,000
Capital improvements	20,000
	$100,000
Minus: Depreciation (on 3 rented units only)	40,000
Adjusted basis	$ 60,000
Selling price	$120,000
Selling expense	$ 8,000
New home:	
Purchase price	$ 70,000

Because one-fourth of the apartment building is your home, you figure the gain on which tax is postponed as follows:

	Personal (1/4)	Rental (3/4)
1) Selling price	$30,000	$90,000
2) Selling expense	2,000	6,000
3) Amount realized (adjusted sales price)	$28,000	$84,000
4) Basis (including improvements)	$25,000	$75,000
5) Depreciation	-0-	40,000
6) Adjusted basis	$25,000	$35,000
7) Gain [(3) minus (6)]	$ 3,000	$49,000
8) Gain not postponed		$49,000
9) Gain postponed	$ 3,000	

The gain of $49,000 on the three-fourths of he building that was rental property is subject o tax in the year of sale. This gain is reported on Form 4797, *Gains and Losses From Sales or Exchanges of Assets Used in a Trade or Business and Involuntary Conversions.* The tax is postponed on the gain on the one-fourth that was your home because the $28,000 adjusted sales price of this one-fourth was less than the $70,000 cost of your new home. The basis of the new home is $67,000 ($70,000 cost minus $3,000 postponed gain).

Business use of your home. If, in the year of sale, you deduct expenses for the business use of your home, you cannot postpone the tax on the gain on the part of the home used for business. In figuring the amount of gain you may postpone, you must make an allocation for the business-use portion of the home.

Example 1. Bill Brown, a doctor, purchased a home in January 1979 for $70,000 and lived in it as his principal home until December 1985. Bill used part of his home exclusively on a regular basis to see his patients in the normal course of his medical practice. From 1979 to 1985, Bill claimed a deduction on his returns for the business use of his home. In December 1985, Bill sold his home for $120,000 and purchased a new principal home for $140,000. In figuring the amount of gain Bill may postpone, he must make an allocation for the business part of his home. Bill will postpone only the tax on the part of the gain that is for the personal-use part of his home.

Example 2. In 1971, Susan Jones bought a home for $40,000 and lived in it as her principal home. Susan is a school teacher and uses part of her den to correct papers and prepare her lessons. On Susan's returns for years 1971 through 1975, she was allowed a deduction for the business use of her home. However, for 1976 and later years, she was not allowed this deduction because she did not use her den exclusively for business purposes, nor was it for the convenience of her employer. However, Susan continued to use part of her den to correct papers and prepare her lessons. In November 1985, Susan sold her home for $80,000 and purchased a new principal home for $90,000. Because Susan was not allowed a deduction for the business use of her den on her 1985 return, she does not have to make any allocation in figuring the amount of gain she may postpone. Susan will postpone the entire tax on the gain on the sale of the old home.

Note. Although Susan will postpone the entire gain, in figuring the amount of her gain, Susan will have to adjust the basis of her old home by any depreciation claimed in years 1971 through 1975 for the business use of her home.

Home changed to rental property. You may not postpone tax on the gain on rental property, even though it was once used as your home. The rules explained in this publication generally will not apply to its sale or exchange. Gains are taxable and losses are deductible, as explained in Publication 527, *Rental Property.* Publication 527 also explains how to figure the basis of this property.

If you temporarily rent out your old principal home before selling it, or your new principal home before living in it, as a matter of convenience, or for some other nonbusiness purpose, any gain on the sale of the property will qualify for treatment under the rules explained in this publication.

Example. In January your employer tells you that you will be transferred to New Jersey in April. Before you leave, you try to sell your principal home, but by April you still have not been able to sell it. In May you buy a new principal home in New Jersey and rent out your old home, while still trying to sell it. In October you sell your old home. Although you temporarily rented out your old home, it is still considered to be your principal home and you may be able to postpone the gain on the sale of the old home. For information on how to treat the rental income you receive, see Publication 527.

If you place your home with a real estate agent for rent or sale and it is not rented, it will not be considered business property or property held for the production of income. The rules explained in this publication will apply to the sale.

Condemnation. If your home is condemned for public use and you have a gain, you may either postpone the tax on the gain under the rules explained in this publication, or you may choose to treat the transaction as an involuntary conversion. The replacement periods allowed under the two treatments may be different and you should compare the replacement periods under both.

If you treat the transaction as an involuntary conversion, to postpone tax on the gain, you must buy, within a specified period, replacement property that costs at least as much as the net proceeds received from the involuntary conversion.

In a condemnation, or the threat or imminence of one, the replacement period begins on the date you disposed of the property, or the date condemnation was threatened or was imminent, whichever is earlier. Generally, the replacement period ends 2 years after the close of the first tax year in which you realize any part of the gain on the conversion.

Example. You are a calendar year taxpayer. You were notified by the city council on March 3, 1983, of its plan to acquire your property, by condemnation if necessary. On June 1, 1985, when your property had an adjusted basis of $40,000, the city condemned the property and paid you $50,000. Your replacement period started on March 3, 1983, the date you were notified of the plan to condemn the property. Because you did not dispose of the property until 1985, your replacement period ends on December 31, 1987, 2 years after the last day of the year in which you realized the gain.

Involuntary conversions by condemnation are discussed in Publication 549, *Condemnations and Business Casualties and Thefts.*

Gain on casualty. The tax on a gain from fire, storm, or other casualty cannot be postponed under the rules explained in this publication, but may be postponed under the rules in Publication 547, *Nonbusiness Disasters, Casualties, and Thefts.*

Option. If you grant an option to buy your home, add the amount you receive for the option to the sale price of your home if the option is exercised. If the option is not exercised, you must report the amount you receive as ordinary income for the year the option expires. You report this amount on line 22 of Form 1040.

Property taxes. You may deduct property taxes in the year of sale based on the number of days in the year that you owned the property. It does not matter what part of those taxes you actually paid. If the buyer paid delinquent taxes that you owed, as part of the contract price of your home, the payment increases the amount you realized on the sale. For more information, see Publication 530, *Tax Information for Owners of Homes, Condominiums, and Cooperative Apartments.*

Transfer taxes. You may not deduct transfer taxes, stamp taxes, and other incidental taxes and charges on the sale of a home as itemized deductions. However, if you pay these amounts as the seller of the property, they are expenses of the sale and reduce the amount you realize on the sale. If you pay these amounts as the buyer, they are included in your cost basis of the property. If you deduct these expenses as moving expenses, you may not use them either to reduce the amount realized on the sale of the home or to increase the cost basis of the new home.

Time for Replacement

If you sold your old home after July 20, 1981, the time allowed to replace your old home and occupy your new home is a 48-month period. That is, if, within 2 years before or 2 years after you sell your old home, you buy or build and live in another home, you may be able to postpone the tax on the gain on the sale of your old home.

Occupancy test. You must physically live in the replacement home as your principal home within the required period. If you move furniture or other personal belongings into the new home but do not actually live in it, you have not met the occupancy test.

No added time for replacement and occupancy beyond the specified periods is allowed. There may be a suspension of time, discussed later, for certain members of the armed forces and people abroad. If you had a gain on the sale of your old home and did not buy or build and live in another home within the specified replacement period, you have no more time for replacement or occupancy. This rule applies even if you are kept from doing so by conditions beyond your control, such as the destruction of the replacement home while it is being built.

If you do not replace the home in time, you must file an amended return for the year of sale and report the entire gain on the sale of your old home. Also, if you began building your new home within the specified period, but for any reason were unable to live in it within 2 years, you do not have any more time for occupancy and must report your entire gain on an amended return for the year of sale.

Members of the armed forces. The replacement period after the sale of your old home is suspended while you serve on extended active duty in the armed forces. To be on extended active duty you must be serving under a call or order for an indefinite period or for more than 90 days. The suspension applies only if your service begins before the end of the 2-year period. This time plus any period of suspension cannot last for more than 4 years after you sell your home.

Example 1. You sold your home on April 1, 1985. This began your replacement period. You joined the armed forces on July 1, 1985. You have used 3 months of your replacement period (April, May, and June). From July 1, 1985, to June 30, 1987, when you will be discharged, your replacement period is suspended. Your replacement period starts again after your discharge on June 30, 1987, and you have until April 1, 1989, (21 months) to buy and live in your new home. This is a total replacement period of 2 years—3 months before you joined the armed forces and 21 months after your discharge.

Example 2. You are a regular member of the armed forces and sold your home on July 1, 1985. Your tax on the gain from the sale of the old home may be postponed only if you buy, or build, and live in another home by July 1, 1989.

Overseas assignment. If you sell your house after July 18, 1984, the replacement period is suspended while you are stationed outside the United States or while you are required to live in on-base quarters after you return from a tour of duty outside the United States, because the Secretary of Defense has determined that adequate off-base housing is not available at a remote site. The replacement period, plus any period of suspension, cannot last for more than 8 years after you sell your home.

Example. You are a regular member of the armed forces and sell your home on August 1, 1985. During 4 years from August 1, 1985, you serve outside the United States. On returning from serving outside the United States, you are required to live in on-base housing because the Secretary of Defense determined that off-base housing is not available at a remote site. The time to replace your home is suspended while you are serving outside the U.S. or required to reside in on-base housing. Your replacement period plus your period of suspension cannot last beyond August 1, 1993.

Spouse in armed forces. If your spouse is in the armed forces and you are not, the suspension applies to you if you own the old home. Both of you must have used the old home and the new home as your principal home. However, if you are divorced or separated while the replacement period is suspended, the suspension ends for you on the day after the date of the divorce or separation.

People abroad. The replacement period after the sale of your old home is suspended while you have your tax home (place where you live and work) outside the United States. This suspension applies only if your stay abroad begins before the end of the 2-year replacement period. The replacement period, plus the period of suspension, cannot last for more than 4 years after you sell your home.

Example. You sold your home on May 14, 1985. This began your replacement period. On September 14, 1985, you were transferred to a foreign country. You have used 4 months of your replacement period. From September 14, 1985, to June 14, 1987, when you return to the United States, your replacement period will be suspended. Your replacement period starts again when you return on June 14, 1987, and you have until February 14, 1989, (20 months) to buy and live in your new home.

If you are married, this suspension of the replacement period lasts while either you or your spouse has a tax home outside the United States, provided that both of you used the old and the new home as your principal home.

Your tax home is considered to be the city or general area of your main place of business, employment, station, or post of duty. It does not matter where your family lives. More information on tax home is in Publication 463, *Travel, Entertainment, and Gift Expenses.*

Cost of New Home

You use the purchase price of your replacement home to find the gain taxed and the gain postponed on the sale of your old home. Purchase price includes costs incurred within the 48-month replacement period for the following items:

1) Buying or building the home,
2) Rebuilding, and
3) Capital improvements or additions.

You may not consider any costs incurred before or after the 48-month period.

Debts on the new property. The price of a new home includes debts it is subject to when you buy it and the face amount of your notes or other liabilities (purchase money mortgage or deed of trust) that you give for it.

Zero interest mortgage. If you buy a home and give the seller a noninterest bearing mortgage with payments due over a number of years, the payments due more than 6 months after the date of purchase must be allocated between principal and interest. This interest is deductible as an interest expense if you itemize your deductions on Schedule A (Form 1040). It is not part of the purchase price of the home. You must subtract the interest from the total purchase price in arriving at the cost of the home. For information on how to figure the amount of the unstated interest, see Publication 537.

Temporary housing. If a builder gives you temporary housing while your new home is being finished, you must subtract the value of the temporary housing from the total contract price in arriving at the cost of the new home.

Settlement fees or closing costs. You probably paid an amount in addition to the contract price of the property for settlement fees or closing costs. Several expenses connected with the purchase are not included in the purchase price of the home, but are divided between the buyer and seller, according to the sales contract, local custom, or understanding of the parties. You may deduct some of these costs, such as real estate taxes, mortgage interest, and "points" that are deductible as interest, in the year you buy the house if you itemize your deductions. For more information, see Publication 545, *Interest Expense,* and Publication 530. You may add other costs, such as attorney fees and transfer taxes, to the basis of your home. See Publication 551.

You may not deduct, or add to your basis, certain settlement fees or closing costs. These include "points" or loan origination fees that are not deductible as interest, fire insurance premiums, FHA mortgage insurance premiums, charges for the use of utilities, rent for occupancy before closing, and other fees or charges for services concerning occupancy of the house.

Investment in retirement home. You have not bought a replacement home if you sell your home and invest the amount you receive for it in a retirement home project that will give you living quarters and personal care but which does not give you any legal interest in the property. Therefore, you must include in income any gain on the sale of your home. However, if you are 55 or older, see *Exclusion of Gain,* later in this publication.

Allocation between you and your spouse. Sometimes either you or your spouse may own the old home separately, but title to the new one is in both your names as joint tenants. Or, you may own the old home as joint tenants and either you or your spouse may own the new home separately. In such cases, the gain from the sale of the old home on which tax is postponed and the resulting adjustment to the basis of the new home may be allocated between you and your spouse.

You may make the allocation only if:

1) Both of you use the old and new homes as your principal home, and
2) Both of you file a consent with the Internal Revenue Service. It may be filed in the bottom margin of Form 2119, *Sale or Exchange of Principal Residence,* or on an attached statement by writing: "We consent to reduce the basis of the new residence by the gain from selling the old residence." Both of you must sign the consent.

If both of you do not consent, you must figure gain on the sale of the old home in the regular way without allocation.

Example 1. You sell, for an adjusted sales price of $48,000, the principal home of yourself and your spouse, which you own individually, and which has an adjusted basis of $36,000. Within 2 years after the sale you and your spouse contribute $25,000 each from your separate funds to buy your new principal home—title to be held jointly. If you and your spouse file a consent to allocate the basis of the new home, the gain on the sale of your old

home will be postponed, and you and your spouse will each have an adjusted basis of $19,000 in the new home. If you do not file a consent, your entire gain of $12,000 on the sale of the old home will be taxed, because you individually did not reinvest any of your gain in the new home. Both you and your spouse will then have a basis of $25,000 each in the new home.

Example 2. Assume in Example 1 that you and your spouse each owned half interest in your old home, and your spouse buys your new home with separate funds and takes title individually. If you and your spouse file the consent, the $12,000 gain from the sale of your old home will be postponed and your spouse will have an adjusted basis of $38,000 in the new home. If you do not file the consent, you will be taxed on your share of the gain on the old home, but your spouse will postpone recognition of his or her share of the gain, because it was reinvested in the new home. Your spouse's basis in the new home will be $44,000 ($50,000 cost minus $6,000 postponed gain).

Example 3. Assume in Example 1 that you own your old home individually and your spouse owns your new home individually. If you and your spouse file the consent, the gain of $12,000 from the sale of your old home will be postponed and your spouse will have an adjusted basis in the new home of $38,000. If you do not file the consent, your entire gain will be taxed and your spouse's basis in the new home will be $50,000.

Separate homes replaced by single home. The tax on the gains by you and your spouse from the sales of homes that had been your separate principal homes before your marriage will be postponed, if you buy a new principal home for more than the combined adjusted sales prices of the old homes and take joint title to the new home. Report the sales of the old homes on separate Forms 2119. Divide the purchase price of the new home between you and your spouse.

Title to new home not held by either you or your spouse. If you invest the amount you receive from the sale of the old home in a new home in which neither you nor your spouse hold any legal interest, title being held by someone else, such as your child, you may ***not*** postpone the tax on the gain on the sale of the old home.

Home replaced by two homes by spouses living apart. The postponement provisions apply separately to the gains realized by you and your spouse from the sale of your principal home where you have agreed to live apart and you each bought and lived in a separate replacement home.

Example. You and your spouse bought a home in 1980. You owned the property as tenants by the entirety and used it as your principal home. In 1985, you agreed to live apart, and sold the home for $60,000. The gain on the sale was $20,000. Under state law, each of you is entitled to half the proceeds of the sale. Therefore, each of you had a $10,000 gain from the sale of your home. Before the end of 1985, you and your spouse individually bought and lived in separate homes. The cost of each new home, $52,000 and $56,000 respectively, was more than your respective shares of the adjusted sales price of the old home. You and your spouse must postpone the tax on the $20,000 gain on the old home. Your new home has an adjusted basis of $42,000 ($52,000 minus half of $20,000 gain postponed). Your spouse's new home has an adjusted basis of $46,000 ($56,000 minus half of $20,000 gain postponed).

You each report the sale of your home on Form 2119 as if two separate properties were sold. You report half of the sales price and your spouse reports half of the sales price.

Investment in a home combined with business or rental property. If you replace your old home with property used partly as your home and partly for business, you must make an allocation between the gain on which tax is postponed and that on which tax is not postponed.

Example. Your old home had a basis of $30,000. You sold it on September 15 for an adjusted sales price of $55,000. You, therefore, had a gain of $25,000. On October 1, you bought a duplex house for $90,000. You lived in half and rented the other half. Because only half of the $90,000 cost of the duplex ($45,000) is considered an investment in a new principal home, the amount of the proceeds not reinvested in a home is $10,000 ($55,000 minus $45,000). Therefore, you are taxed on $10,000 of the $25,000 gain on the sale of your old home. You must postpone tax on the $15,000 of the gain reinvested in your new home. The basis of your new home is $30,000 ($45,000 cost minus $15,000 postponed gain). The basis of the rented part of the duplex is $45,000.

Inheritance. If you inherit or receive any part of your new home as a gift, you cannot use the value of that part in figuring the gain on the sale of your old home on which tax is postponed. You include the basis of that part, however, in the adjusted basis used in figuring gain when you sell the new home.

Example. Your father died in 1984 and you inherited his home. Its basis to you is $42,000. You spent $14,000 to modernize the home resulting in a basis to you of $56,000. Assume that within 2 years of inheriting your father's home you sell your old home for $45,000, at a gain of $5,000. You have fixing-up expenses of $200 on your old home.

To find the amount of gain to be taxed in the year of the sale, you compare the adjusted sales price of the old home, $44,800 ($45,000 minus $200), with the $14,000 you invested in your new home. Therefore, the $5,000 gain is fully taxed, because the adjusted sales price of the old home is more than the amount you paid to rebuild your new home. You do not use the value of your inherited property ($42,000) to determine the amount you paid for your new home.

No double deduction. You may not decrease the amount realized on the sale of your home by the real estate commission or similar expenses you deduct as a moving expense. You may not increase the basis of a new home by the attorneys' fees or similar expenses you deduct as moving expenses. For more information, see Publication 521.

Holding period. If you postpone tax on any part of the gain on the sale of your old home, you will be considered to have owned your new home for the combined period you owned both the old and the new homes.

Second sale during replacement period. If you sell your new principal home during the replacement period for your old home, you generally may not postpone tax on the gain on the sale of the new home. This is true even if you buy or build another home within the 24-month period discussed earlier.

Example. You sold your principal home in March 1984 at a gain. You postponed tax on the gain because you bought a new home in April 1984 for at least as much as your adjusted sales price of the old home. You then sell your new principal home in June 1985. Even if you buy or build another new principal home within 24 months, you may not postpone tax on the June 1985 sale because it is within 24 months of the March 1984 sale.

Exception. This rule does not apply if you sell or exchange your principal home because of a ***work-related move*** for which you can deduct moving expenses. Thus, if certain requirements are met, you may postpone the gain from the sale of more than one principal home during the replacement period. These requirements relate to the distance between your new work place and your old home, and to the length of time you must work after the move. Your new principal place of work must be at least 35 miles farther from your former home than was your former place of work, or if you had no former place of work, your new place of work must be at least 35 miles from your former home. If you are an employee, you must work full time for at least 39 weeks during the first 12 months after you arrive in the general area of your new job location. If you are self-employed, you must work full time for at least 78 weeks during the 24 months after you arrive in the area of your new job location. For more details on the distance and time requirements, see Publication 521.

More than one new home. If during the replacement period you buy or build more than one principal home, only the last one bought or built in the period may be treated as the ***new home*** in figuring whether you may postpone the tax on the gain from the sale of the old home.

Example. You sold your old principal home on March 15, 1984, at a gain. You bought a new principal home on June 1, 1984. On February 1, 1985, you bought another new principal home. In figuring whether you may postpone tax on the gain on your old home, compare the cost of the new home you bought on February 1, 1985, with the adjusted sales price of the old home sold on March 15, 1984.

Exception. If you sell your home because of a work-related move to which the exception discussed above applies, you should treat this home as the new home in deciding whether you can postpone tax on the gain from the sale of your old home.

Example. In January 1985 you sell your old principal home in Chicago at a gain. In February 1985 you buy a new principal home. In September 1985 you sell your new home after you are transferred by your employer to New York City where you purchase a more expensive home. The move meets the requirements for a moving expense deduction. In deciding whether you can postpone tax on the gain from the sale of your old home, compare the cost of the home bought in February with the adjusted sales price of the home sold in January even though you bought another new principal home within 2 years.

Continued postponement of gain. If you bought your present home in a way that let you postpone tax, you continue to postpone the tax if you replace your present home under the rules explained in this publication.

Example. In 1970 you sold your home, which you had owned since 1960, and bought a new one. The tax on the gain was postponed and the basis of your 1970 home was reduced by the gain you postponed. This year you sold your 1970 home and bought a more expensive one. You may be entitled to again postpone tax on the gain from selling your 1970 home.

How to Report

If you sold or exchanged your home during the year, report the details of the sale as explained here, even if the tax is postponed on all of the gain.

Report sale in year sold on Form 2119. Use Form 2119, *Sale or Exchange of Principal Residence*, to show the details of the sale of your old home and any purchase of a new one. Form 2119 is shown at the end of this publication.

You should keep a copy of your Form 2119 along with your tax records for the year for future proof of basis of a replacement home.

If you do not plan to replace your old home, or if you replace or plan to replace it with a new home costing no more than the adjusted basis of the old home, you must use Form 2119 to report the sale of your old home. Report all the gain from the sale on Schedule D (Form 1040) because you are not investing any of the gain from the sale of your old home in a new one.

Buying and living in a new home. If you buy and live in a new home before you file your return for the year of the sale, and it costs more than the adjusted basis of the old one, you are investing at least part of your gain in the new home. Enter on line 2 (if short-term) or line 10 (if long-term) of Schedule D only the gain on which the tax is not postponed. Attach Form 2119 to your return showing the price of your new home, the date you first lived in it, how you figured the gain on which the tax is and is not postponed, and the adjusted basis of your new home.

If the new home costs at least as much as the adjusted sales price of the old one, you need not report the sale on Schedule D. Attach Form 2119 to your return showing the price of your new home, the date you first lived in it, how you figured the gain on which the tax is postponed, and the adjusted basis of your new home.

Home not yet replaced. If you plan to replace your home but have not done so, or if you are undecided whether you will replace it by the time you file your return, and the replacement period has not run out, you must report the sale. Attach Form 2119 to your return for the year of sale and complete lines 1 and 2 and Part I only.

If you buy a new home after your return is filed but within the replacement period, and it costs you at least as much as the adjusted sales price of your old home, you should write to the Director of the Internal Revenue Service Center where you filed your return, saying that you have replaced your old home. Attach Form 2119 giving the date you first lived in the new home and its cost.

If your new home costs less than the adjusted sales price of your old home, or if you do not buy or build and live in a new home within 2 years after selling your old home, you must file an amended return (Form 1040X) and attach Schedule D (Form 1040) and a Form 2119 for the year of the sale showing the gain you must report. You must pay interest on the extra tax due on the gain you report on your amended return.

If you are divorced after filing a joint return on which you postponed reporting tax on the gain on the sale of your home, but you do not use your share of the proceeds to buy or build a new home (and your former spouse does), you must file an amended joint return to report the tax on your share of the gain. If your former spouse refuses to sign the amended joint return, attach a letter telling why your former spouse will not sign it.

If you paid tax on the gain from the sale of your old home, and you buy and live in a new home within the replacement period, using some or all of the gain on the sale, you should file an amended return and attach Form 2119. Report only the gain on which you cannot postpone the tax, and claim a refund of the rest of the tax.

Installment sale. Some sales are made under arrangements that provide for part or all of the selling price to be paid in a later year. These sales are called "installment sales." If you finance the buyer's purchase of your home yourself, instead of having the buyer get a loan or mortgage from a bank, you probably have an installment sale. You may report on the installment basis the part of the gain you may not postpone if the sale qualifies as an installment sale. See Publication 537.

Interest income. If you sell your home and hold a note, mortgage, or other financial agreement, the interest you receive as part of the payment must be reported as interest income. See *Figuring Installment Sale Income* in Publication 537.

Statute of limitations. If you sell your home at a gain, the period during which you may have to pay tax on the gain will not run out until 3 years after you write to the Internal Revenue Service Center where you filed your return for the year you sold your home stating:

1) That you replaced your old home, and how much the replacement home cost,
2) That you do not plan to buy a new home in time, or
3) That you did not buy a new home in time.

You should send with your letter, if needed, an amended return for the year in which you had the gain and include the gain that you cannot postpone in your income for that year.

Example

Frank and Evelyn Harris bought a new home and went to settlement on May 3, 1985. They sold their old home, which they had bought on November 3, 1974, with settlement taking place on May 6, 1985. They had a gain on the sale of the old home and the price of the new home was less than the adjusted sales price of the old home. Therefore, they must pay tax in 1985 on the gain on the sale of their old home to the extent of the sale proceeds that they did not reinvest in the new home. Neither Frank nor Evelyn was 55 before the date of the sale. (See *Exclusion of Gain*, later.) They report the sale on their Schedule D (Form 1040) and file Form 2119. A filled-in Form 2119 showing this example is included later in this publication.

Frank and Evelyn's records show the following:

1) Original cost of old home including settlement costs	$38,500
2) Improvements to old home (new porch, trees, fence)	4,500
3) Fixing-up expenses—painting	500
4) Selling price of old home	62,000
5) Commission paid on sale	3,700
6) Balance of mortgage on old home	23,000
7) Interest on old mortgage for 5/1/85 to 5/5/85, charged at settlement	5
8) Penalty paid for prepayment of mortgage on old home	60
9) Real estate taxes for 1985 on old home	560
10) Real estate taxes for 1/1/85 to 5/5/85 paid to buyer of old home	192
11) Refund of insurance on old home	25
12) Purchase price of new home	56,200
13) Title search and settlement costs of new home	1,000
14) Real estate taxes for 1985 on new home	625
15) Real estate taxes for 1/1/85 to 5/2/85 received from seller of new home	210
16) 1 year's fire insurance paid in advance on new home	200
17) Mortgage on new home	47,500

Frank and Evelyn use some items in their records in figuring the gain on the sale of their old home or the adjusted basis of the new home. They use other items to figure the deductions allowable on Schedule A (Form 1040). Others they do not show at all. For information on how to treat the mortgage interest and real estate taxes, see Publication 530.

They figure the gain on the sale of their old home, the part on which tax is postponed and the part on which it is not, and the adjusted basis of their new home in the following way (the items referred to appear in the list shown earlier):

Gain realized:	
a) Selling price of old home (item 4)	$62,000
b) Minus: Selling expenses (item 5)	3,700
c) Amount realized on sale	$58,300
d) Minus: Basis of old home (items 1 and 2)	43,000
e) Gain realized	$15,300
Part of gain taxed in 1985:	
f) Amount realized on sale (line (c), above)	$58,300
g) Minus: Fixing-up expenses (item 3, and see discussion earlier in this publication)	500
h) Adjusted sales price	$57,800
i) Minus: Cost of new home (items 12 and 13)	57,200
j) Excess of adjusted sales price over cost of new home	$ 600
k) Gain taxed in 1985 (lesser of lines (e) or (j))	$ 600
Part of gain not taxed in 1985:	
l) Gain realized (line (e), above)	$15,300
m) Gain recognized and taxed on 1985 return (line (k), above)	600
n) Gain not taxed in 1985	$14,700
Adjusted basis of new home:	
o) Cost of new home (line (i), above)	$57,200
p) Minus: Gain not taxed in 1985 (line (n), above)	14,700
q) Adjusted basis of new home	$42,500

Frank and Evelyn attach Form 2119 to their return showing this information. They enter the part of the gain taxed in 1985 on line 10 of Schedule D (Form 1040).

Exclusion of Gain

You may exclude from your gross income some or all of your gain from the sale of your principal home, if you meet certain age, ownership, and use tests at the time of the sale. You may choose to exclude gain only once for sales or exchanges after July 26, 1978.

Age, Ownership, and Use

You may choose to exclude from your gross income $125,000 of gain ($62,500 if you are married filing separately) on the sale or exchange of your principal home if:

1) You were 55 or older on the date of the sale or exchange, and
2) You ***owned and lived in*** the property sold or exchanged as your principal home for at least 3 years out of the 5-year period ending on the date of the sale or exchange, and
3) You or your spouse have never excluded gain on the sale or exchange of a home after July 26, 1978.

Age 55 at time of sale. You must reach 55 by the date you sell the home to qualify for the $125,000 exclusion. You do not meet the age 55 test if you sell the property during the year in which you will be 55 but before you actually become 55. The earliest date on which you may sell your home and still qualify for the exclusion is your 55th birthday.

Ownership and use test. The required 3 years of ownership and use during the 5–year period ending on the date of the sale or exchange do not have to be continuous. You meet the test if you can show that you owned and lived in the property as your principal home for either 36 full months or 1,095 days (365 × 3) during the 5–year period. Short temporary absences for vacations, or other seasonal absences, even if you rent out the property during the absences, are counted as periods of use. See *Ownership and use tests met at different times*, later.

Example 1. Joseph Mooney lived with his son and daughter-in-law in a house owned by his son from 1978 through 1982. On January 4, 1983, he bought this house from his son and continued to live there until May 31, 1985, when he sold it. Although Joseph ***lived in*** the property as his principal home for more than 3 years, he cannot exclude his gain on the sale, because he did not ***own*** the property for the required 3 years.

Example 2. Professor John Thomas bought and moved into a house on January 2, 1982, and lived in it as his principal home continuously until February 1, 1984, when he went abroad for a 1–year sabbatical leave. During part of the period of leave, the property was unoccupied, and during the rest of the period, he rented it out. On March 1, 1985, he sold the house. Because his leave was not a short temporary absence, he may not include the period of leave in meeting the test that he must have lived in the house as his principal home for 3 years or more. He may not exclude his gain from income, because he did not live in the house for the required period.

More than one owner. If a husband and wife who meet the age, ownership, and use tests sell their jointly owned home, they are considered one for finding the gain to be excluded from income. But if the joint owners of a home are other than husband and wife, each individual owner who meets the age, ownership, and use tests may exclude his or her gain on an individual basis.

Each such owner who chooses to exclude gain from gross income must meet the age, ownership, and use tests. If one owner meets the tests, that does not automatically qualify the other owners to exclude their gain from gross income. A choice by one owner does not keep the other owners from making a similar choice in the future.

Example. Frank Smith and his sister, Mary, each own a half interest in their jointly owned home. They both meet the age, ownership, and use tests. The adjusted basis of the home is $28,000, or $14,000 each. They sell the home and the adjusted sales price is $140,000. The adjusted sales price of Frank's interest in the home is $70,000 (½ × $140,000). He may choose to exclude from gross income his entire gain of $56,000 ($70,000 minus $14,000). Mary may also choose to exclude her entire gain from income.

Previous home destroyed or condemned. If you sold or exchanged your principal home, you may add the time you owned and lived in a previous home that was destroyed or condemned to the time you owned and lived in the home on which you wish to exclude gain, for meeting the ownership and use tests. This applies if any part of the basis of the home you sold or exchanged depended on the basis of the destroyed or condemned home. Otherwise, you must have owned and lived in the ***same*** home that was sold or exchanged for 3 out of the 5 years before the sale or exchange to qualify for the exclusion.

Ownership and use tests met at different times. The ownership and use tests may be met during different 3–year periods as long as both tests are met during the 5–year period ending on the date of the sale or exchange.

Example. In 1978, Grace Jones was 50 years old and lived in a rented apartment. The apartment building was later changed to a condominium and she bought her apartment on December 1, 1981. In 1983, Grace became ill and on April 15 of that year she moved to a nursing home. On February 15, 1985, while still in the nursing home, she sold her apartment.

Grace may exclude the gain on the sale of her apartment, because she met the age, ownership, and use tests. Grace was over 55 at the time of the sale. Her 5–year period is from February 16, 1980, to February 15, 1985, the date she sold the apartment. She owned her apartment from December 1, 1981, to February 15, 1985, (over 3 years). Grace lived in the apartment from February 16, 1980, to April 15, 1983, (over 3 years).

Amount excluded. If you meet the age, ownership, and use tests, you may choose to exclude $125,000 of your gain on the sale or exchange of your home. If you are married filing separately, you may choose to exclude only $62,500 of gain on the sale or exchange. Your gain is the amount realized minus the adjusted basis of the home. If there is gain remaining after the exclusion, you may be able to postpone the rest of the gain if, as explained earlier, you buy and live in another home.

Example. Tom White, a single person, sold his principal home on September 13, 1985. He bought the home in August 1975. Tom was 58 years old when he sold the house and had owned and lived in the property as his principal home for the past 10 years. He has never excluded a gain on the sale or exchange of a home. This year he chooses to exclude the gain on the sale of his home. Tom's Form 2119 is shown later in this publication.

Tom figures the gain on the sale of his home in the following way:

a) Selling price of home	$130,000
b) Minus: Selling expenses	10,000
c) Amount realized on sale	$120,000
d) Minus: Basis of old home (original cost plus improvements)	50,000
e) **Gain realized**	$ 70,000

Because Tom is not planning to replace his home, he does not complete Part III of Form 2119. He completes lines 1, 2, and 3, and Parts I and II of Form 2119 and attaches it to his tax return.

Principal Home

Principal home has the same meaning for the exclusion of gain as it has for postponing tax on gain. See *Principal Home* earlier in this publication.

When you use only part of the property as your principal home, as explained earlier, the rules discussed in this section of the publication apply only to the gain on the sale or exchange on the part of the property used as your principal home.

Example. Dr. Martin Russell met the age, ownership, and use tests when he sold his principal home. However, for the whole time he owned the home, he used half of it exclusively as an office for treating his patients. Only the half of the property used as his home qualifies for the choice to exclude gain from gross income, because Dr. Russell did not use the whole property as his principal home. See *Property partly used as your home*, discussed earlier, for an example of how to divide the gain between the part of the property used as your home and the part used for business or other purposes.

If you trade your old home for a different home, the trade is treated as a sale and a purchase. Gain on the old home may qualify for exclusion from gross income.

Land. If you sell the land on which your principal home is located, but not the house itself, you may not exclude from income any gain you have from the sale of the land. This rule applies to sales after March 27, 1983.

If your home is condemned for public use, you may treat the transaction as a sale of the home. If you choose to exclude gain on it from gross income, you must first exclude it as explained in this part of the publication. You may postpone the tax on the rest of the gain as explained earlier, or you may postpone it under the rules for an involuntary conversion, discussed in Publication 549, *Condemnations and Business Casualties and Thefts.*

If your home is damaged by fire, storm, or other casualty, you may choose to exclude gain from insurance proceeds or other compensation, as explained in this part of the publication. However, ***unlike a condemnation gain,*** you may not postpone the tax on the rest of the gain as explained earlier in this publication. The rest may qualify, however, for the tax treatment that applies to involuntary exchanges explained in Publication 547, *Nonbusiness Disasters, Casualties, and Thefts.*

Jointly owned home. Both you and your spouse will meet the age, ownership, and use tests if:

1) You hold the home either as joint tenants, tenants by the entirety, or as community property on the date of the sale or exchange, and
2) You file a joint return for the tax year in which you sell the home, and
3) Either you or your spouse is 55 or older on the date of sale and has owned and lived in the property as a principal home for the required time before the sale or exchange.

Home of spouse who died. You will meet the ownership and use tests if on the date you sell your principal home:

1) Your spouse is deceased, and
2) You have not remarried, and
3) Your deceased spouse had met the ownership and use tests for that principal home, and
4) Your deceased spouse had not previously chosen or joined in choosing to exclude gain on the sale or exchange of another principal home after July 26, 1978.

Example. Ellen and Doug Smith were married January 1, 1983, and afterwards lived in, as their principal home, property that Doug had owned and lived in continuously as his principal home since January 1, 1975. Doug died on January 1, 1985, never having chosen or joined in choosing to exclude gain on the sale or exchange of any home.

Ellen inherited the property and continued to live in it as her principal home until December 10, 1985, when she sold it. At the date of sale she was 56 years old, had not remarried, and had never chosen or joined in choosing to exclude gain on the sale or exchange of any home. Because Doug, during the 5–year period ending on the date Ellen sold the property, met the 3–year ownership and use tests for this property, and because Ellen meets the age test, she may choose to exclude from her gross income up to $125,000 of the gain on the sale of her home. See *Making and Revoking a Choice to Exclude Gain*, discussed later.

Sale by executor. Gain from the sale of a home by the executor of an estate qualifies for this exclusion, if the sale is made under a contract entered into before death by a taxpayer who met the age, ownership, and use tests.

Effect of Marital Status

You determine your marital status as of the date of sale or exchange of the home. If you are divorced by the date of the sale or exchange, you are not considered married.

If you are married at the time you sell or exchange your principal home, you may not choose to exclude the gain unless your spouse joins you in making the choice. Your spouse must join you in the choice even if:

1) You or your spouse owned the home separately,
2) You and your spouse filed separate returns, or
3) The spouse not owning an interest in the home had not lived in it for the required period before the sale or exchange.

If your spouse died after the sale or exchange but before making the choice to exclude the gain, his or her personal representative (for example, administrator or executor) must join with you in making the choice. You, as the surviving spouse, are considered the personal representative of your deceased spouse if no one else has been appointed.

If the home is not jointly owned, the spouse who owns the property must meet the age, ownership, and use tests discussed earlier. The other spouse must join in making the choice.

Separate return. If you are married and file a separate return and you meet the tests discussed earlier, you may choose to exclude no more than $62,500 of gain on the sale or exchange of your principal home. Your spouse must show agreement to your choice by writing in the bottom margin of Form 2119 or on an attached statement, "I consent to Part II election" and signing his or her name.

You or your spouse may exclude gain only once. If you or your spouse chooses to exclude gain from a sale or exchange after July 26, 1978, neither of you may choose to exclude gain again for a sale or exchange after that date. If you and your spouse each owned separate homes before your marriage and sold both homes after your marriage, you may exclude the gain on one of them, but not on both. If after choosing to exclude gain, you and your spouse divorce, neither of you may exclude gain again. If you remarry, you and your new spouse may not exclude gain on sales or exchanges after your marriage. However, a previous choice may be revoked as discussed later under *Making and Revoking a Choice to Exclude Gain.*

Example 1. Frank and Sheila Brown were married. In January 1984 they sold their jointly owned home. Frank and Sheila met the age, ownership, and use tests, so they chose to exclude their gain of $70,000 on their joint return for 1984. The Browns divorced in February 1985.

In July 1985 Sheila married Mike Jones. Mike had sold his home in March 1985 when he was single. He met the age, ownership, and use tests at the time of sale. If Mike and Sheila file a joint return for 1985, Mike may choose to exclude up to $125,000 gain because he was single at the time he sold his home. This is so even though Sheila joined Frank in choosing to exclude gain.

If Mike files a separate return for 1985, he may exclude only up to $62,500 gain.

Example 2. Joe Johnson and Betty Smith were single and each owned a home. In August 1985 they sold their homes and each had a gain of $125,000 for a total gain of $250,000. Each met the age, ownership, and use tests at the time of sale.

In October 1985 Joe and Betty married. Because Joe and Betty were single when they sold their homes, they each may choose to exclude $125,000 of gain ($250,000 total) if they file a joint return. If they file separate returns each may exclude only $62,500.

Example 3. In February 1985, Bill and Sally White were divorced. At that time they had their jointly owned home up for sale. Sally married Ken Brown in November 1985. In December 1985 Bill and Sally's home was sold. Because Bill and Sally were not married to each other at the time their home was sold and they each met the tests to exclude gain, each may choose to exclude up to $125,000 gain based on the part of the home each owned. (See *Example* under *More than one owner,* earlier.) Sally files a joint return and chooses to exclude up to $125,000 of her part of the gain. Ken joins Sally in her choice. Bill files a single return and chooses to exclude up to $125,000 of his gain.

If Ken Brown later sells a home, he may not choose to exclude gain because he was required to join Sally in her choice to exclude gain. Ken is considered to have made a lifetime choice.

Example 4. David and Beth Pine sell their jointly owned home. They both meet the ownership and use tests at the time of sale but David is 62 and Beth is 50. They file separate returns for the year their house is sold. Because Beth does not meet the age test, she may not choose to exclude gain on her separate return. David may choose to exclude gain on his separate return only if Beth joins him in making his choice, but he may exclude only up to $62,500 of the gain.

If Beth did join David in making his choice and she later sells a home, she may not choose to exclude gain because she joined David in his choice to exclude gain.

Making and Revoking a Choice to Exclude Gain

You may exclude gain on the sale or exchange of your principal home only ***once*** for sales or exchanges after July 26, 1978.

Time to exclude gain. You may make or revoke a choice to exclude gain from a particular sale or exchange at any time before the latest of the following dates:

- Three years from the due date of the return for the year of the sale,
- Three years from the date the return was filed, or
- Two years from the date the tax was paid.

Making the choice. You make the choice by attaching a filled-in Form 2119, *Sale or Exchange of Principal Residence,* to your income tax return for the year in which you sell or exchange your home. However, if you do not have Form 2119, you can make the choice by attaching a signed statement to your return. The statement must say that you choose to exclude from income the gain from the sale or exchange. It must also include:

1) Your name, age, social security number, and marital status on the date of the sale or exchange. If jointly owned, give this information for each owner,
2) The dates you bought and sold the home,
3) The adjusted sales price and the adjusted basis of the property on the date of sale,
4) How long you were away from the home during the 5 years before the sale, except for vacation and other seasonal absences, even if you rented out the home during these absences, and
5) Whether you or a joint owner ever chose to exclude gain on the sale of a home, and if you did, when and where you did so. If you revoked the choice, give the date it was revoked.

You may, after originally reporting the gain on the sale of your home, choose to exclude the gain from taxable income. You do so by filing an amended return on Form 1040X. You must send a filled-in Form 2119 or a statement with your amended return.

Revoking the choice. The spouse who joined you in making the choice must join you in revoking it. If your spouse is deceased, his or her personal representative must join in revoking any choice previously made by you and your deceased spouse, or by you and his or her personal representative. You revoke your choice in a signed statement showing your name and social security number. Include in the statement the year in which you made the choice. Send it to the Internal Revenue Service Center where you filed the choice, the Service Center now nearest you, or your local Internal Revenue Service office.

Example. On October 2, Joe Brown sold his separately owned home. Two months later his wife Joyce died, leaving a will that appointed the First National Bank of Hometown as her executor. Joe had the First National Bank of Hometown join him in making the choice. If he later wants to revoke the choice, the First National Bank of Hometown must join in revoking it.

If at the time you revoke your choice less than a year is left in the assessment period (time for determining your correct tax) for the tax year for which the choice was made, you must agree, in writing, that the assessment period will not run out before the end of one year after the filing of the statement. You must file this agreement before the end of the assessment period for the tax year you made the original choice to exclude gain. The assessment period normally ends on the latest of the dates shown earlier under *Time to exclude gain.*

Filing your return. Even if you exclude the gain on the sale of your home from gross income, you must consider that gain in determining whether you had enough income to require you to file a return.

Form **2119**

Department of the Treasury
Internal Revenue Service

Sale or Exchange of Principal Residence

▶ See instructions on back.

▶ Attach to Form 1040 for year of sale (see instruction B).

OMB No. 1545-0072

1985

21

Name(s) as shown on Form 1040. FRANK AND EVELYN HARRIS

Your social security number 222 00 2222

Do not include expenses that you deduct as moving expenses.

1 a	Date former residence sold ▶ May 6, 1985			
b	Enter the face amount of any mortgage, note (for example, second trust), or other financial instrument on which you will receive periodic payments of principal or interest from this sale ▶ N/A			
2 a	If you bought or built a new residence, enter date you occupied it; otherwise enter "None" ▶ May 3, 1985		Yes	No
b	Are any rooms in either residence rented out or used for business for which a deduction is allowed? (If "Yes," see instructions)			X
3 a	Were you 55 or over on date of sale?			X
b	Was your spouse 55 or over on date of sale? If you answered "No" to 3a and 3b, do not complete 3c through 3f and Part II.			X
c	Did the person who answered "Yes" to 3a or 3b own and use the property sold as his or her principal residence for a total of at least 3 years (except for short absences) of the 5-year period before the sale?			
d	If you answered "Yes" to 3c, do you elect to take the once in a lifetime exclusion of the gain on the sale?			
e	At time of sale, was the residence owned by: ☐ you, ☐ your spouse, ☐ both of you?			
f	Social security number of spouse, at time of sale, if different from number on Form 1040 ▶ (Enter "None" if you were not married at time of sale.)			

Part I Computation of Gain

4	Selling price of residence less expense of sale. (Do not include personal property items.)	4	58,300
5	Basis of residence sold	5	43,000
6	Gain on sale (subtract line 5 from line 4). If zero or less, enter zero and do not complete the rest of form. Enter the gain from this line on Schedule D, line 2 or 10*, unless you bought another principal residence or checked "Yes" to 3d. Then continue with this form	6	15,300

If you haven't replaced your residence, do you plan to do so within the replacement period? ☐ Yes ☐ No
(If "Yes" see instruction B.)

Part II Age 55 or Over One-Time Exclusion

Complete this part only if you checked "yes" to 3(d) to elect the once in a lifetime exclusion; otherwise, skip to Part III.

7	Enter the smaller of line 6 or $125,000 ($62,500, if married filing separate return)	7	
8	Gain (subtract line 7 from line 6). If zero, do not complete rest of form. Enter the gain from this line on Schedule D, line 10*, unless you bought another principal residence. Then continue with this form	8	

Part III Gain To Be Postponed and Adjusted Basis of New Residence

Complete this part if you bought another principal residence.

9	Fixing-up expenses (see instructions for time limits)	9	500
10	Adjusted sales price (subtract line 9 from line 4)	10	57,800
11	Cost of new residence	11	57,200
12	Gain taxable this year (subtract line 11 plus line 7 (if applicable) from line 10). If result is zero or less, enter zero. Do not enter more than line 6 or line 8 (if applicable). Enter the gain from this line on Schedule D, line 2 or 10*.	12	600
13	Gain to be postponed (subtract line 12 from line 6. However, if Part II applies, subtract line 12 from line 8)	13	14,700
14	Adjusted basis of new residence (subtract line 13 from line 11)	14	42,500

***Caution:** If you completed Form 6252 for the residence in 1a, do not enter your taxable gain from Form 2119 on Schedule D.

Form **2119**

Department of the Treasury
Internal Revenue Service

Sale or Exchange of Principal Residence

▶ See instructions on back.

▶ Attach to Form 1040 for year of sale (see instruction B).

OMB No. 1545-0072

1985

21

Name(s) as shown on Form 1040. TOM WHITE

Your social security number 333 00 3333

Do not include expenses that you deduct as moving expenses.

		Yes	No
1 a	Date former residence sold ▶ SEPTEMBER 13, 1985		
b	Enter the face amount of any mortgage, note (for example, second trust), or other financial instrument on which you will receive periodic payments of principal or interest from this sale ▶ N/A		
2 a	If you bought or built a new residence, enter date you occupied it; otherwise enter "None" ▶ NONE		
b	Are any rooms in either residence rented out or used for business for which a deduction is allowed? (If "Yes," see instructions)		X
3 a	Were you 55 or over on date of sale?	X	
b	Was your spouse 55 or over on date of sale? If you answered "No" to 3a and 3b, do not complete 3c through 3f and Part II.	N/A	
c	Did the person who answered "Yes" to 3a or 3b own and use the property sold as his or her principal residence for a total of at least 3 years (except for short absences) of the 5-year period before the sale?	X	
d	If you answered "Yes" to 3c, do you elect to take the once in a lifetime exclusion of the gain on the sale?	X	
e	At time of sale, was the residence owned by: ☒ you, ☐ your spouse, ☐ both of you?		
f	Social security number of spouse, at time of sale, if different from number on Form 1040 ▶ (Enter "None" if you were not married at time of sale.) NONE		

Part I Computation of Gain

4	Selling price of residence less expense of sale. (Do not include personal property items.)	4	120,000
5	Basis of residence sold	5	50,000
6	Gain on sale (subtract line 5 from line 4). If zero or less, enter zero and do not complete the rest of form. Enter the gain from this line on Schedule D, line 2 or 10*, unless you bought another principal residence or checked "Yes" to 3d. Then continue with this form	6	70,000

If you haven't replaced your residence, do you plan to do so within the replacement period? (If "Yes" see instruction B.) ☐ Yes ☒ No

Part II Age 55 or Over One-Time Exclusion

Complete this part only if you checked "yes" to 3(d) to elect the once in a lifetime exclusion; otherwise, skip to Part III.

7	Enter the smaller of line 6 or $125,000 ($62,500, if married filing separate return)	7	70,000
8	Gain (subtract line 7 from line 6). If zero, do not complete rest of form. Enter the gain from this line on Schedule D, line 10*, unless you bought another principal residence. Then continue with this form	8	-0-

Part III Gain To Be Postponed and Adjusted Basis of New Residence

Complete this part if you bought another principal residence.

9	Fixing-up expenses (see instructions for time limits)	9	
10	Adjusted sales price (subtract line 9 from line 4)	10	
11	Cost of new residence	11	
12	Gain taxable this year (subtract line 11 plus line 7 (if applicable) from line 10). If result is zero or less, enter zero. Do not enter more than line 6 or line 8 (if applicable). Enter the gain from this line on Schedule D, line 2 or 10*.	12	
13	Gain to be postponed (subtract line 12 from line 6. However, if Part II applies, subtract line 12 from line 8)	13	
14	Adjusted basis of new residence (subtract line 13 from line 11)	14	

***Caution:** If you completed Form 6252 for the residence in 1a, do not enter your taxable gain from Form 2119 on Schedule D.

For Paperwork Reduction Act Notice, see back of form.

Form **2119** (1985)

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